

## MANAGEMENT'S DISCUSSION AND ANALYSIS

As the management of Lee County, we offer readers of Lee County's financial statements this narrative overview and analysis of the financial activities of the County for the fiscal year ended June 30, 2005. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the County's financial statements, which follow this narrative.

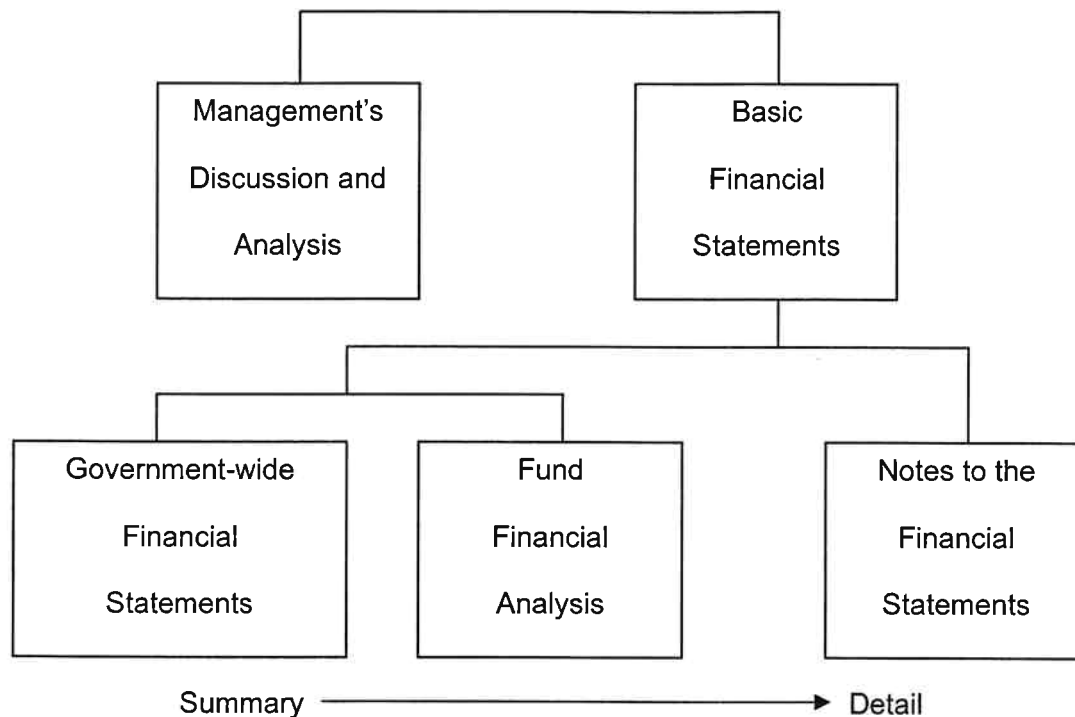
### Financial Highlights

- The liabilities of Lee County exceeded its assets at the close of the fiscal year by (\$6,023,663) (*net assets*).
- Lee County's total net assets decreased by \$16,441,039 due to the sale of the assets of the Lee County Water & Sewer District #1 to the City of Sanford and the expenditure of loan proceeds on capital projects.
- As of the close of the 2005 fiscal year, the County's governmental funds reported combined ending fund balances of \$21,400,990, a decrease of \$16,286,968 from the prior year. 59.7 percent of this total amount, or \$12,785,924, is available for spending at the government's discretion (*unreserved fund balance*).
- At the end of the 2005 fiscal year, undesignated and designated fund balance for the General Fund was \$9,684,501 or 20.6 percent of total general fund expenditures for the fiscal year. Of this amount, \$2,811,519 has been designated for subsequent year's expenditures and other purposes leaving \$6,872,982 or 14.6 percent of total general fund expenditures undesignated.
- The County maintained its A1 bond rating from Moody's Investor Services and its and A+ bond rating from Standard & Poor's.
- Lee County's total debt decreased by \$11,776,506 or 19.7 percent during the current fiscal year. The key factor in this decrease was the pay off of debt related to the Lee County Water & Sewer District #1.

### Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Lee County's basic financial statements. The basic financial statements consist of three components: 1) the government-wide financial statements, 2) the fund financial statements, and 3) the notes to the financial statements (see Figure 1). The basic financial statements present two different views of the County through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of Lee County.

## Required Components of Annual Financial Report Figure 1



### Basic Financial Statements

The first two statements (Exhibits 1 and 2) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the County's financial status.

The next statements (Exhibits 3 through 10) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the County's governments. These statements provide more detail than the government-wide statements. There are four parts to the Fund Financial Statements: 1) the governmental funds statements; 2) the budgetary comparison statements; 3) the proprietary fund statements; and 4) the fiduciary fund statements.

The next section of the basic financial statements is the **notes**. The notes to the financial statements explain in detail some of the data contained in those statements. After the notes, **supplemental information** is provided to show details about the County's non-major governmental funds, which are added together in one column on the basic financial statements. Budgetary information required by North Carolina General Statutes also can be found in this part of the statements.

Following the notes is the required supplemental information. This section contains funding information about the County's pension plan.

## **Government-wide Financial Statements**

The government-wide financial statements are designed to provide the reader with a broad overview of the County's finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the County's financial status as a whole.

The two government-wide statements report the County's net assets and how they have changed. Net assets are the difference between the County's total assets and total liabilities. Measuring net assets is one way to gauge the County's financial condition.

The government-wide statements are divided into two categories: 1) governmental activities and 2) business-type activities. The governmental activities include most of the County's basic services such as public safety, parks and recreation, human services and general administration. Property taxes and state and federal grant funds finance most of these activities. The business-type activities are those that the County charges customers to provide. These include water and sewer and landfill services offered by Lee County.

The government-wide financial statements are on Exhibits 1 and 2 of this report.

## **Fund Financial Statements**

The fund financial statements provide a more detailed look at the County's most significant activities. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The County, like all other governmental entities in North Carolina, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the County's budget ordinance. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

**Governmental Funds** – Governmental funds are used to account for those functions reported as governmental activities in the government-wide financial statements. Most of the County's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash flow in and out, and what monies are left at year-end that will be available for spending the next year. Governmental funds are reported using an accounting method called *modified accrual accounting* which provides a current financial resources focus. As a result, the governmental fund financial statements give the reader a detailed short-term view that helps him or her determine if there are more or less financial resources available to finance the County's programs. The relationship between government activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

Lee County adopts an annual budget for its General Fund, as required by the General Statutes. The budget is a legally adopted document that incorporates input from the citizens of the County, the management of the County, and the decisions of the Board

about which services to provide and how to pay for them. It also authorizes the County to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund demonstrates how well the County complied with the budget ordinance and whether or not the County succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement uses the budgetary basis of accounting and is presented using the same format, language, and classifications as The Statement of Revenues, Expenditures and Changes in Fund Balance. The statement shows four columns: 1) the original budget as adopted by the Board; 2) the final budget as amended by the Board; 3) the actual resources, charges to appropriations, and ending balances in the General Fund; and 4) the difference or variance between the final budget and the actual resources and charges.

**Proprietary Funds** – Lee County has one kind of proprietary fund. *Enterprise Funds* are used to report the same functions presented as business-type activities in the government-wide financial statements. The County uses enterprise funds to account for its water and sewer activity and for its landfill operations. These funds are the same as those separate activities shown in the business-type activities in the Statement of Net Assets and the Statement of Activities.

**Fiduciary Funds** – Fiduciary funds are used to account for resources held for the benefit of parties outside the government. The County has nine fiduciary funds, a pension trust fund, the Brown Bequest Trust Fund and seven agency funds.

**Notes to the Financial Statements** – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements start on page 23 of this report.

**Other Information** – In addition to the basic financial statements and accompanying notes, this report includes certain required supplementary information concerning the County's progress in funding its obligation to provide pension benefits to its public safety employees. Required supplemental information can be found on page 46 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets over time may serve as a useful indicator of a government's financial condition. The figure below depicts the County's net assets for fiscal year 2005 and provides comparative data from fiscal year 2004.

**Lee County's Net Assets**  
**Figure 2**

	2005	2004 (restated)	2005	2004	2005	2004 (restated)
Current and other assets	\$ 27,835,895	\$ 42,972,808	\$ 937,649	\$ 2,125,919	\$ 28,773,544	\$ 45,098,727
Capital assets	19,245,782	18,224,879	859,456	12,951,025	20,105,238	31,175,904
Total assets	<u>47,081,677</u>	<u>61,197,687</u>	<u>1,797,105</u>	<u>15,076,944</u>	<u>48,878,782</u>	<u>76,274,631</u>
Long-term liabilities outstanding	49,041,156	52,774,734	28,425	8,024,085	49,069,581	60,798,819
Other liabilities	5,797,168	4,781,867	35,696	276,569	5,832,864	5,058,436
Total liabilities	<u>54,838,324</u>	<u>57,556,601</u>	<u>64,121</u>	<u>8,300,654</u>	<u>54,902,445</u>	<u>65,857,255</u>
Net assets:						
Investment in capital assets, net						
of related debt	12,958,415	10,448,506	859,456	4,816,025	13,817,871	15,264,531
Restricted	7,201,990	20,880,095	-	-	7,201,990	20,880,095
Unrestricted	(27,917,052)	(27,687,515)	873,528	1,960,265	(27,043,524)	(25,727,250)
Total net assets	<u>\$ (7,756,647)</u>	<u>\$ 3,641,086</u>	<u>\$ 1,732,984</u>	<u>\$ 6,776,290</u>	<u>\$ (6,023,663)</u>	<u>\$ 10,417,376</u>

The liabilities of Lee County exceed assets by (\$6,023,663) at the close of the most recent fiscal year. One of the largest portions of net assets reflects the County's investment in capital assets (e.g. land, buildings, machinery and equipment), less any related debt still outstanding that was issued to acquire those items. Lee County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Lee County's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities. An additional portion of the County's net assets, \$7,201,990, represents resources that are subject to external restrictions on how they may be used. The remaining deficit balance of \$27,043,524 is unrestricted.

As with many counties in the State of North Carolina, the County's Governmental Activities deficit in unrestricted net assets is due primarily to the portion of the County's outstanding debt incurred for the Lee County Board of Education (the "schools") and Central Carolina Community College (the "community college"). Under North Carolina law, the county is responsible for providing capital funding for the school and community college systems. The County has chosen to meet its legal obligation to provide the systems capital funding by using a mixture of County funds, general obligation debt and installment financings. The assets funded by the County; however, are titled to, and utilized by the school and community college systems. Since the County, as the issuing government, acquires no capital assets, the County has incurred a liability without a corresponding increase in assets. As of June 30, 2005, approximately \$42.0 million of the outstanding debt on the County's financial statement was related to assets included in the school and community college systems' financial statements.

The impact on unrestricted governmental net assets of the inclusion of the school system debt without the corresponding assets was offset by the following positive factors:

- Continued diligence in the collection of current year property taxes by maintaining a collection percentage of 97.41 percent for real and personal property and 87.05 percent for motor vehicles.
- Continued low cost of debt due to the County's high bond rating.

**Lee County's Changes in Net Assets**  
**Figure 3**

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Revenues:</b>						
Program revenues:						
Charges for services	\$ 2,260,570	\$ 2,315,650	\$ 2,047,224	\$ 2,601,794	\$ 4,307,794	\$ 4,917,444
Operating grants and contributions	7,832,632	7,348,865	67,765	149,445	7,900,397	7,498,310
Capital grants and contributions	413,400	633,385	48,691	465,302	462,091	1,098,687
General revenues:						
Property taxes	26,271,487	25,869,230	-	-	26,271,487	25,869,230
Other taxes	9,996,510	9,928,020	-	-	9,996,510	9,928,020
Grants and contributions not restricted to specific programs	141,921	272,749	-	-	141,921	272,749
Other	1,882,833	1,523,604	(4,901,566)	(643,648)	(3,018,733)	879,956
Total revenues	48,799,353	47,891,503	(2,737,886)	2,572,893	46,061,467	50,464,396
<b>Expenses:</b>						
General government	5,829,053	5,120,577	-	-	5,829,053	5,120,577
Public safety	7,483,289	7,698,199	-	-	7,483,289	7,698,199
Economic and physical development	15,955,571	12,797,321	-	-	15,955,571	12,797,321
Human services	14,541,954	13,705,752	-	-	14,541,954	13,705,752
Cultural and recreation	1,595,953	1,734,880	-	-	1,595,953	1,734,880
Education	12,385,372	11,738,642	-	-	12,385,372	11,738,642
Interest on long-term debt	2,405,894	1,737,550	-	-	2,405,894	1,737,550
Water and sewer	-	-	1,030,102	1,608,198	1,030,102	1,608,198
Landfill	-	-	1,275,318	1,208,279	1,275,318	1,208,279
Total expenses	60,197,086	54,532,921	2,305,420	2,816,477	62,502,506	57,349,398
Increase (decrease) in net assets	(11,397,733)	(6,641,418)	(5,043,306)	(243,584)	(16,441,039)	(6,885,002)
Net assets, July 1, restated	3,641,086	10,282,504	6,776,290	7,019,864	10,417,376	17,302,368
Net assets, June 30	\$ (7,756,647)	\$ 3,641,086	\$ 1,732,984	\$ 6,776,280	\$ (6,023,663)	\$ 10,417,366

**Governmental activities.** Governmental activities decreased the County's net assets by \$11,397,733. Key elements of this decrease are as follows:

- Increase in human service expenses required under various federal and state matching requirements and mandates.
- Decrease in capital grants and contributions due to prior year one-time revenue for various capital projects.
- Increases in educational spending.

- Increases in interest due related to the issuance of Certificates of Participation in the prior year.
- The following offset a portion of the net asset decreases represented above:
  - Property tax revenue increased due to growth in tax base.
  - Increased operating grants and contributions due to increased revenues from Homeland Security grants and other State and federal programs.
  - Investment earnings increased by \$399,375 due in part to an overall higher rate of return on investments during the year.

**Business-type activities.** Business type activities decreased the County's net assets by \$5,043,306. The decrease is attributable to the sale of the assets of the Lee County Water & Sewer District #1 and of the Golden Poultry Water Fund to the City of Sanford.

### **Financial Analysis of the County's Funds**

As noted earlier, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental Funds.** The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the County's financing requirements. Specifically, unreserved fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

The General Fund is the chief operating fund of the County. At the end of the current fiscal year, unreserved and undesignated fund balance of the General Fund was \$6,872,982, while total fund balance reached \$13,502,313. As a measure of the general fund's liquidity, it may be useful to compare both unreserved and undesignated fund balance and total fund balance to total fund expenditures. Unreserved and undesignated fund balance represents 14.6 percent of the total General Fund expenditures, while total fund balance represents 28.7 percent of that same amount.

At June 30, 2005, the governmental funds of the County reported a combined fund balance of \$21,400,990, a 43.2 percent decrease from the prior year. The primary reason for the decrease is the use of construction funds in the New High School Construction Fund. The decrease is also attributable to the use of funds in the State School Bond Reserve Fund for debt service.

**General Fund Budgetary Highlights.** During the fiscal year, the County revised the budget on several occasions. Generally, the budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants; and 3) increases in appropriations that become necessary to maintain services. Total amendments to the General Fund's budget were an increase of \$1,862,274.

Major budget increases during the year include:

- Carry forward of unfinished County projects from 6-30-04 of \$379,085.
- Increase of \$400,000 for Medicaid expenditures
- Increase of \$468,978 due to additional Federal and State funds for various programs.
- Increase of \$149,496 to begin a full list and measure tax base revaluation project.

Ad valorem taxes were \$650,088 over budget as a result of greater than expected growth in the tax base. Local option sales taxes collections were \$727,064 higher than expected, the projection of which was made difficult by changes made by the State in the method and timing of distributions. Sales and services revenues were \$559,511 under budget due primarily to health department fee collections being \$237,354 less than expected and to jail fees being \$148,286 less than budgeted. Actual expenditures were under the final budget by \$3,533,611 with the majority of the positive variances occurring in General Government and Human Services.

**Proprietary Funds.** Lee County's proprietary funds provide the same type of information found in the government-wide statements but in more detail. Unrestricted net assets for the Water and Sewer District # 1 Fund at the end of the fiscal year amounted to \$5,275, a decrease of \$3,908,443 from the prior year due to the sale of the water system to the City of Sanford. The unrestricted net assets of the Solid Waste Management Fund equaled \$868,253. The Solid Waste Management Fund continues to work with the slightest margins trying to balance ever increasing costs within its existing fee structure. Other factors concerning the finances of these funds have already been addressed in the discussion of Lee County business-type activities.

### **Capital Asset and Debt Administration**

**Capital assets.** The County's investment in capital assets for its governmental and business-type activities as of June 30, 2005, totals \$20,105,238 (net of accumulated depreciation). These assets include land, buildings, machinery and equipment, improvements, construction in progress and water and sewer lines.

Major capital asset transactions during the year include:

- Purchase and replacement of public safety vehicles.
- Development of a new parks and recreation facility.
- Sale of water systems to the City of Sanford

**Lee County's Capital Assets  
(net of depreciation)  
Figure 4**

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Land	\$ 2,256,674	\$ 2,347,401	\$ 260,425	\$ 348,419	\$ 2,517,099	\$ 2,695,820
Land improvements	242,923	242,923	-	-	242,923	242,923
Buildings	11,205,337	12,156,567	256,065	273,604	11,461,402	12,430,171
Waterlines	-	-	-	11,314,785	-	11,314,785
Tanks	-	-	-	515,511	-	515,511
Wells and pumps	-	-	-	4,952	-	4,952
Equipment	1,712,999	1,849,061	342,966	493,754	2,055,965	2,342,815
Construction in progress	3,827,849	1,628,927	-	-	3,827,849	1,628,927
Totals	\$ 19,245,782	\$ 18,224,879	\$ 859,456	\$ 12,951,025	\$ 20,105,238	\$ 31,175,904

Additional information on the County's capital assets can be found in Note III. D. of the Basic Financial Statements.

**Long-term Debt.** As of June 30, 2005, Lee County had total debt outstanding of \$47,990,187, of which General Obligation Bonds are backed by the full faith and credit of the County and all other debt is covered by pledged collateral and is subject to appropriation.

**Lee County's Outstanding Debt  
Figure 5**

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
General Obligation Bonds	\$ 19,030,000	\$ 21,875,000	\$ -	\$ 8,030,000	\$ 19,030,000	\$ 29,905,000
Installment Debt	28,960,187	29,861,693	-	-	28,960,187	29,861,693
Totals	\$ 47,990,187	\$ 51,736,693	\$ -	\$ 8,030,000	\$ 47,990,187	\$ 59,766,693

Lee County's total debt decreased by \$11,776,506 during the past fiscal year. \$8,030,000 of the reduction is due to the sale of the County's water systems to the City of Sanford. The remaining decrease is due to principal payments.

As mentioned in the financial highlights section of this document, Lee County maintained its A1 bond rating from Moody's Investor Service and A+ rating from Standard and Poor's Corporation. These bond ratings are a clear indication of the sound financial condition of Lee County.

The State of North Carolina limits the amount of general obligation debt that a unit of government can issue up to 8 percent of the total assessed value of taxable property located within that government's boundaries. The legal debt margin for Lee County is \$245,754,769.

Additional information regarding Lee County's long-term debt can be found in note III. N.

## **Economic Factors and Next year's Budgets and Rates**

The following economic indicators reflect the growth and prosperity of the County.

- The unemployment rate for Lee County at June 30, 2005 was 5.7 percent, a decrease from a year ago when it was 6.0 percent. The rate is slightly above the state average.
- Approximately 375 new jobs were added in 2004.

## **Budget Highlights for the Fiscal Year Ending June 30, 2006**

**Governmental Activities.** The County has approved a \$54,694,426 general fund budget for fiscal year 2006, which represents a \$6,095,748 increase from the actual expenditures and other financing uses for the year ended June 30, 2005. The budget growth was funded by a 12 cent tax increase as well as projected sales tax revenue growth. The County will use those revenues to finance programs currently in place, pay a significant amount of school debt service, and fund a 23.3 percent increase in current expense funding for the Lee County School System.

**Business-type activities.** Disposal and collection fees for the solid waste fund increased \$2.50 each per household. Rates were increased to assure that the fund was covering its expenditures.

## **Requests for Information**

This report is designed to provide an overview of the County's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance, Lee County, 106 Hillcrest Drive, P.O. Box 1968, Sanford, NC 27330.